



September 15, 2008

AGENDA ITEM 3

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Policy Subcommittee Report
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:**
 - a. Asset Allocation – Adoption of Policy on Affiliate Funds and Repeal of Policy on Annuitants' Healthcare Coverage Fund
 - b. Real Estate – Revision of Policy on International Equity Real Estate
 - c. Policy Review and Consolidation Project – Revision of Policy on Alternative Investment Management (AIM) Program
- IV. ANALYSIS:**

Background

The Policy Subcommittee met on August 18, 2008. The Subcommittee reviewed a new policy for the Affiliate Funds. In addition, the Subcommittee reviewed proposed revisions to the International Equity Real Estate Policy and the Alternative Investment Management (AIM) Program Policy.

The proposed new and revised Policies are attached. Unless otherwise noted, the revised Policies are presented as black-lined versions from the last adopted policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double underline to indicate additions. Single underline does not indicate a change; rather it indicates that the term is defined in the glossary.

Each of the recommended policies is explained below.

Adoption of Policy on Affiliate Funds and Repeal of Policy on Annuitants' Healthcare Coverage Fund

The Asset Allocation/Risk Management Unit administers the asset allocation strategy and monitors the performance for the following affiliate funds: Annuitants' Healthcare Coverage Fund, Judges' Retirement System II, Legislators' Retirement System, Long-Term Care Fund, and Supplemental Contribution Plan Portfolio Fund.

During the Policy Review and Consolidation Project, staff noted the absence of a policy to administer the Affiliate Funds. With the exception of the Annuitants' Healthcare Coverage Fund Policy, formal investment policy had not previously been established for the Affiliate Funds.

As such, staff presented and recommended adoption of the Affiliate Funds Policy (Attachment 1) to the Subcommittee and recommended repeal of the existing Annuitants' Healthcare Coverage Fund (Attachment 2). The text of the existing Annuitants' Healthcare Coverage Fund policy has been incorporated into the proposed Affiliates Policy.

The Subcommittee recommended adoption of the Affiliates Policy and repeal of the Annuitants' Healthcare Coverage Fund policy.

Revision of Policy on International Equity Real Estate

Staff recommended the following changes to the International Equity Real Estate Policy (Attachment 3):

1. Establish a geographical division of the real estate universe in terms of three sectors: Developed Markets, Emerging Markets, and Frontier Markets;
2. Create ranges and limitations for real estate investments in the three sectors;
3. Clarify that Frontier Market investments require Committee approval except for minimal percentages within commingled funds; and,
4. Acknowledge that the CalPERS Emerging Equity Markets Principles and the United Nations Principles for Responsible Investing will guide emerging market investments in the real estate portfolio.

The Subcommittee recommended approval of the revised policy with a technical correction to the Developed Markets allocation range.

Policy Review and Consolidation Project – Revision of Policy on Alternative Investment Management (AIM) Program Policy

The objectives of the Policy Review Project are (1) to organize and streamline Investment Policy to improve access, clarity and transparency, (2) to provide a consistent Investment Policy framework, and (3) to ensure that the policies will facilitate the on-going CalPERS compliance program.

The Policy Review Project entails a detailed review of each policy with the goal of updating and streamlining the policy, as well as potential consolidation with other related policies. In addition to these goals, the review and revisions include the following:

- Removal of delegations from policy. During the Delegations Project, staff reviewed all policies, minutes, and delegations to identify and consolidate delegations. Delegations are now located in consolidated documents.
- Removal of operational and procedural language, which is now located in staff internal procedure manuals.
- Conformance to the new template.

The review is a joint effort and includes input from the General Pension Consultant and Alternative Investment Management Consultant, the CalPERS Legal Office, and the Enterprise Office of Compliance.

A clean version of the AIM Program Policy is included as Attachment 4. A black-line version of the policy was provided in the August 18, 2008 Policy Subcommittee agenda materials. Staff recommended one substantive change to the policy which is explained below.

Staff recommended changing the short term benchmark to the Custom Young Fund Universe median return without making any adjustments for the weights within the AIM Portfolio. This change is recommended based on the benchmark used in the Performance Plans approved by the Performance and Compensation Committee at their June 17, 2008 meeting.

The policy was further edited for clarity and to conform to the new template. The deletions from the policy were either definitional and are now linked to the Glossary or were procedural in nature.

Staff did not recommend changes to the Restricting AIM Investments in Public Sector Outsourcers Policy because the policy was developed with close input from constituent representatives, as well as the general partner community.

The Subcommittee recommended approval of the revised Alternative Investment Management (AIM) Program policy.

Proposed 2009 Meeting Schedule

The Subcommittee approved the 2009 Policy Subcommittee meeting date schedule, which is attached for the Investment Committee's information (Attachment 5). The Subcommittee noted that the schedule is subject to change.

V. STRATEGIC PLAN:

This item supports Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

The results of this item will provide CalPERS with enhanced efficiencies and ability to manage the overall portfolio. The revised policies will provide a foundation for compliance, accountability, and transparency.

Matt Flynn
Division Chief

Anne Stausboll
Interim Chief Investment Officer